

Message Text

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ACTION SS-25

INFO OCT-01 ISO-00 SSO-00 /026 W
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P 232119Z SEP 75

FM AMEMBASSY CARACAS

TO SECSTATE WASHDC PRIORITY 264

C O N F I D E N T I A L CARACAS 9952

EXDIS

E.O. 11652: XGDS

TAGS: ENRG, PFOR, VE

SUBJECT: PETROLEUM REVERSION: FINANCIAL CONSTRAINT AS
LEVER FOR NEGOTIATIONS

REF A. STATE 219364; B. STATE 225006

1. BEGIN SUMMARY: EMBASSY AGREES THAT GOV WILL HAVE SIZEABLE SHORT TERM FINANCIAL REQUIREMENT AFTER JAN 1, 1976. THERE WILL BE 2 REASONS FOR REQUIREMENT: 1) THE LAG IN PAYMENTS FOR OIL SALES ON CREDIT TERMS; AND 2) THE FACT THAT THE GOV WILL BE MAKING SOME CASH COMPENSATION PAYMENTS TO THE CONCESSIONAIRES OVER THE SAME SHORT-TERM TIME FRAME. HOWEVER, PROVISION APPEARS TO HAVE BEEN MADE TO COVER THE CASH GAP, AND OUR ASSESSMENT IS THAT FINANCIAL CONSTRAINT IS NOT AN EFFECTIVE LEVER FOR NEGOTIATIONS. END SUMMARY.

2. IT IS RECOGNIZED BY ALL PARTIES THAT THERE WILL BE A CASH FLOW GAP FACING PETROVEN, BEGINNING JAN 1, OF FAIRLY SIZEABLE PROPORTIONS. EXACTLY HOW MUCH THE FINANCIAL REQUIREMENT WILL BE IS STILL BEING ANALYZED. OUR ESTIMATE IS THAT IT WILL BE SOMETHING IN EXCESS OF \$300 MILLION FOR THE FIRST THREE MONTHS OF 1976. THIS CALCULATION INCLUDES \$200 MILLION PLUS FOR PRODUCTION COSTS AND \$100 MILLION PLUS FOR CASH PAYMENTS TO THE OIL COMPANIES. NO FACTOR IS USED FOR CONTINUATION OF INVESTMENT PROGRAMS AND MAINTENANCE DURING THE FIRST QUARTER.

3. PRODUCTION COSTS FOR THE QUARTER ARE BASED ON THE ASSUMPTION OF A DAILY PRODUCTION AVERAGE OF 2.2 MILLION BARRELS AT AN
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AVERAGE COST OF ONE DOLLAR PER BARREL. IN JAN 1975 THE GOV

REPORTED THAT 1974 PRODUCTION COSTS WERE 75 CENTS PER BARREL FOR CRUDE AND \$1.10 PER BARREL FOR PRODUCT. SINCE PRODUCTION IS ABOUT EVENLY DIVIDED BETWEEN CRUDE AND REFINED PRODUCTS, THE AVERAGE PER BARREL COST IN JAN 75 WAS SLIGHTLY OVER 90 CENTS. SINCE THEN, PRODUCTION HAS DECLINED SHARPLY AND MATERIAL COSTS HAVE INCREASED WHILE OVERHEAD HAS REMAINED RELATIVELY CONSTANT. THUS, OUR ASSUMPTION THAT PRODUCTION COSTS HAVE RISEN DURING 1975.

4. THE BULK OF VENEZUELAN OIL SALES HAVE TRADITIONALLY BEEN UNDER CONTRACT TERMS, AND HAVE PROVIDED FOR CREDIT OF AS MUCH AS 90 DAYS IN CERTAIN INSTANCES. ALL SUCH CONTRACTS WILL BE SUPERCEDED BY THE NEW SALES AGREEMENTS TO BE SIGNED WITH PETROVEN EFFECTIVE JAN 1. THIS MEANS THAT PAYMENTS FOR OIL DELIVERIES WILL BE MADE TO THE COMPANIES UNTIL DEC 31, AND THEREAFTER TO PETROVEN. CREDIT TERMS UNDER THE NEW PETROVEN SALES CONTRACTS ARE ONE OF THE KEY ELEMENTS IN THE NEGOTIATIONS. RELIABLE COMPANY SOURCES TELL US THAT THE RANGE HAS BEEN NARROWED TO 45 TO 60 DAYS, TO BE COUNTED BEGINNING AFTER THE END OF THE MONTH DURING WHICH THE SALE IS CONCLUDED. THUS, IF THE SLAE IS MADE ON 45-DAY CREDIT TERMS IN THE EARLY PART OF THE LAST HALF OF A MONTH, THE EFFECTIVE CREDIT TERMS WOULD BE ALMOST SIXTY DAYS. IF THE SALE TERMS CALL FOR 60 DAYS CREDIT, THE EFFECTIVE CREDIT COULD BE ALMOST 75 DAYS IF THE CONTRACT WERE TO BE WRITTEN JUST AFTER THE 15TH OF THE PRECEEDING MONTH. WE ARE UNCLEAR ON WHETHER SALES CONTRACTS WOULD BE ALLOWED IN THE FIRST HALF OF A MONTH.

5. WHETHER THE FINAL AGREEMENT REACHED IS 45 OR 60 DAYS, IT IS CLEAR THAT THERE WILL BE NO SIGNIFICANT CASH RECEIPTS BY PETROVEN FOR THE FIRST TWO MONTHS OF 1976. HOWEVER, THERE WILL BE A SPECIFIED VOLUME OF OIL LIFTINGS UNDER THE TERMS OF THE CONTRACTS TO BE SIGNED AND, IF THERE IS A COLD WINTER IN THE U.S. LIFTINGS WILL IN ALL LIKELIHOOD EXCEED THE MINIMUMS IN THE AGREEMENTS.

6. RATHER THAN RECEIVING CASH INFLOW DURING THE QUARTER, PETROVEN MAY BE REQUIRED TO MAKE SIZEABLE CASH PAYMENTS TO THE FORMER CONCESSIONAIRES. OUR SOURCES INDICATE THAT THERE IS GENERAL AGREEMENT THAT PETROVEN WILL PAY FOR THE CONCESSIONAIRES' OIL INVENTORIES AS MEASURED ON JAN 1, AND WILL ALSO PAY FOR MATERIAL AND EQUIPMENT INVENTORIES IN THE WAREHOUSES AS OF THE SAME DATE. THE SUMS INVOLVED ARE SIGNIFICANT. ONE SOURCE ESTIMATES THE OIL

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INVENTORY WILL BE ABOUT 40 MILLION BARRELS, AND STATES THE GOV HAS AGREED TO PAY FOUR DOLLARS PER BARREL. THE FOUR DOLLAR FIGURE IS CALCULATED TO COVER PRODUCTION COSTS AND ALLOW A PROFIT TO THE COMPANIES. WE ARE UNABLE TO ACCURATLEY MEASURE THE VALUE OF MATERIAL AND EQUIPMENT INVENTORIES. THIS TOTAL SHOULD NOT APPROACH THE \$160 MILLION ESTIMATE FOR OIL, SINCE IT WILL APPLY ONLY TO PRE-1975 EQUIPMENT AND MATERIAL PURCHASES. (THE 1975 PURCHASES ARE BEING PAID FOR ON A CURRENT BASIS THROUGH THE DEVICE OF ALLOWING

THE COMPANIES TO TAKE A DOLLAR FOR DOLLAR TAX OFFSET FOR SUCH PURCHASES.) PETROVEN WILL NOT HAVE TO PAY FOR THE OIL INVENTORY IN ONE LUMP SUM. IT HAS ASKED TO PAY THE AMOUNT IN SEVERAL INSTALLMENTS, AND THE COMPANIES ARE AGREEABLE.

7. THE GOV IS FULLY COGNIZANT OF THE FINANCIAL GAP THAT WILL OCCUR WHEN PETROVEN TAKES OVER THE NATIONALIZED INDUSTRY ON JAN 1, 1976. IT HAS LAREADY MADE A SUPPLEMENTARY BUDGET ALLOCATION FROM 1975 FUNDS OF ONE BILLION BOLIVARS (\$230 MILLION) TO EFFECT THE REGISTRATION OF PETROVEN. (WE UNDERSTAND THAT BS 570 MILLION (\$132.6 MILLION) OF THIS WAS IMMEDIATELY APPLIED TO MEET THE TAX OBLIGATIONS OF CVP.) IN ADDITION, A SECOND TRANCHE OF BS1.5 BILLION (\$354 MILLION) IS INCLUDED IN THE 76 BUDGET BILL WHICH IS SCHEDULED TO BE CONSIDERED BY CONGRESS IN OCT 75. ASSUMING BUDGET APPROVAL, PETROVEN SHOULD BEGIN 76 WITH WORKING CAPITAL OF WELL OVER \$400 MILLION. THIS FIGURE DOES NOT APPEAR TO HAVE BEEN ARRIVED AT ACCIDENTALLY, AND WE CAN ONLY ASSUME THAT IT IS BASED ON THE GOV ESTIMATE OF WORKING CAPITAL REQUIREMENTS FOR THE PERIOD OF THE GAP.

8. AFTER JAN 1, 76, THE MECHANISM FOR FINANCING PETROVEN HAS BEEN INCORPORATED INTO THE NATIONALIZATION LAW (ARTICLE 6, PARA5). PETROVEN WILL RECEIVE TEN PERCENT OF THE MONTHLY NET INCOME OF PETROLEUM EXPORTS FROM THE OPERATING COMPANIES (LAGOVEN, MARAVEN, MENEVEN, COROVEN, ETC.). THIS SUM WILL BE EXEMPT FROM ALL NATIONAL TAXES AND CONTRIBUTIONS, AND WILL BE DEDUCTIBLE BY THE OPERATING COMPANIES FOR THE PURPOSES OF INCOME TAXES.

9. HOW MUCH THE MONTHLY INCOME WILL BE IS A MATTER OF SPECULATION AT THIS POINT. THIS WILL DEPEND ON OIL PRICES NOW BEING NEGOTIATED AND THE VOLUMES TO BE LIFTED. MINES MIN HERNANDEZ PREDICTED IN MID-AUG THAT PETROVEN WILL RECEIVE AN ANNUAL INCOME OF BS 3BILLION AND THAT THIS SUM WOULD ADEQUATELY COVER PROJECTED INVESTMENTS. CONFIDENTIAL

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10. IN ADDITION TO THE INITIAL WORKING CAPITAL AND LEGAL PROVISION FOR CONTINUING FUNDS, PETROVEN CAN EASILY GO TO COMMERCIAL BANKING COMMUNITY. WE UNDERSTAND THAT ONE OF GENERAL RAFEAL ALFONZOS CURRENT HEADACHES INVOLVES FENDING OFF ENTREATIES OF THE BANING COMMUNITY. SIGNIFICANTLY, ONE OF THE FOUR FULL-TIME PETROVEN BOARD MEMBERS IS EDGAR LEAL, FORMERLY VICE PRESIDENT OF FIRST NATIONAL CITY BANK IN VENEZUELA. HE IS KNOWN TO BE REVIEWING OIL INDUSTRY CASH FLOW DATA, TOGETHER WITH MINES MINISTRY REPORTS ON FINANCIAL REQUIREMENTS OF THE INDUSTRY. LEAL IS BEING WINED AND DINED BY THE BANKING INDUSTRY, INCLUDING A BEVY OF BRITISH BANKERS LAST WEEK.

11. THE EMBASSY REPORTED IN CARACAS 9282 THAT THE GOV HAS TAKEN A DECISION NOT TO UTILIZE THE VENEZUELAN INVESTMENT FUND AS THE

FINANCING VEHICLE FOR PETROVEN DUE TO COMPLICATING LEGAL PROBLEMS. PROBABLY A SECOND BUT EQUALLY IMPORTANT FACTOR IS THAT VENFUND WOULD INVOLVE ADDITIONAL BUREAUCRATIC STRATIFICATION WHICH THE GOV INTENDS TO AVOID TO THE EXTENT POSSIBLE.

12. COMMENT: THE GOV SEEMS TO HAVE ADEQUATELY ANTICIPATED THE SHORT-TERM FINANCIAL REQUIREMENTS OF THE NATIONALIZED INDUSTRY. (WHETHER THE SAME CAN BE SAID WITH RESPECT TO LONG-TERM INVESTMENT NEEDS IS OPEN TO QUESTION.) WE SEE NO NEGOTIATING LEVERAGE HERE, NOR DO THE COMPANY NEGOTIATORS APPEAR TO DISCERN ANY OPENINGS IN THAT QUARTER. WHATEVER THE REQUIRMENTS PROVE TO BE IN PRACTICE, THE GOV HAS THE MONEY.
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Message Attributes

Automatic Decaptioning: Z
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: PETROLEUM INDUSTRY, NATIONALIZATION, NEGOTIATIONS
Control Number: n/a
Copy: SINGLE
Draft Date: 23 SEP 1975
Decaption Date: 28 MAY 2004
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: GolinoFR
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975CARACA09952
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D750330-1053
From: CARACAS
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19750923/aaaaatwo.tel
Line Count: 182
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION SS
Original Classification: CONFIDENTIAL
Original Handling Restrictions: EXDIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: EXDIS
Reference: 75 STATE 219364, 75 STATE 225006
Review Action: RELEASED, APPROVED
Review Authority: GolinoFR
Review Comment: n/a
Review Content Flags:
Review Date: 15 SEP 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <15 SEP 2003 by CunninFX>; APPROVED <29 OCT 2003 by GolinoFR>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
06 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: ETROLEUM REVERSION: FINANCIAL CONSTRAINT AS LEVER FOR NEGOTIATIONS
TAGS: ENRG, PFOR, EFIN, VE, US, TEXACO
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 06 JUL 2006